

C.

Texas Department of Banking

Industry

and

Departmental Operations

and

Legislative Activities



Charles G. Cooper
Commissioner

TEXAS DEPARTMENT OF BANKING

2601 North Lamar Blvd., Austin, Texas 78705
512-475-1300 / 877-276-5554
www.dob.texas.gov

To: Finance Commission Members

From: Kurt Purdom, Director of Bank & Trust Supervision

Date: April 2, 2012

Subject: Summary of the Bank & Trust Supervision Division Activities

Bank and Trust Supervision					FY 2012							
FY2010		FY2011		1 st		2 nd		3 rd		4 th		
Industry Profile (# / Assets (billions))												
# Banks	316	\$161.9	307	\$159.4	304	\$168.4	302	\$170.3				
# Trust Co. (1)	20	\$17.4	22	\$20.4	22	\$19.1	22	\$20.4				
# FBA/FBB	10	\$73.5	10	\$97.5	10	\$97.9	10	\$93.0				
Examinations Performed												
Banks	171		169		38		39					
Trust Co.	48		37		8		6					
FBA/FBB	3		5		1		1					
Bank CAMELS (# / %)												
1	120	38.0%	116	37.8%	111	36.5%	115	38.1%				
2	139	44.0%	140	45.6%	145	47.7%	140	46.4%				
3, 4, & 5	56	17.7%	51	16.6%	48	15.8%	47	15.5%				
Non-Rated	1	0.3%	0	-	0	-	0	-				

(1) Public trust companies only.

April 2, 2012

Administrative/Enforcement Actions (Number outstanding as of the date indicated)		FY 2012				
	8/31/2010	8/31/2011	11/30/2011	2/29/2012	5/31/2012	8/31/2012
Banks - Safety and Soundness						
Formal	17	18	18	16		
Informal	57	53	56	58		
Banks - Bank Secrecy Act (BSA)						
Formal	1	1	1	0		
Informal	4	1	1	1		
Banks - Information Technology (IT)						
Formal	0	0	0	0		
Informal	4	3	3	4		
Trust Departments of Banks and Trust Companies						
Formal	0	0	0	0		
Informal	1	1	1	1		
Total Administrative/Enforcement Actions						
Formal	18	19	19	16		
Informal	66	58	61	64		
Total	84	77	80	80		

Formal actions include Orders to Cease and Desist, Consent Orders and Written Agreements.

Informal actions include Determination Letters, Memoranda of Understanding, Commitment Letters and Board Resolutions.

Orders of Supervision, Orders of Conservatorship and Compliance actions are not included.

Compliance with Examination Priorities (Past Due Examinations)			
Entity Type	12/31/2011	01/31/2012	02/29/2012
Commercial Banks			
Total by Responsibility (TDOB/FDIC/FRB)	12/3/1	9/6/0	8/8/0
IT	1/2/1	2/4/0	2/8/0
Trust	0/1/0	1/0/0	1/0/0
Foreign Bank Agencies			
Total by Responsibility (TDOB/FRB)	0/1	0/1	0/1
Trust Companies			
Total by Responsibility (DOB Public/Exempt)	0/1	0/0	0/0
IT	0	0	0
Total of All Entities			
Total by Responsibility (TDOB/FDIC/FRB)	14/6/3	12/10/1	11/16/1

Total

23

23

28

Division Highlights

- Seminar/Panel/Conference Participation:
 - Various staff members attended Independent Bankers Association of Texas (IBAT) Regional Meetings held in cities around the state. (2/6 – 3/1)
 - Director Robinson participated in meetings of the CSBS Enhanced Prudential Standards Group. This working group conducted a review of Federal Reserve Board proposals for the application of certain provisions of the Dodd-Frank Act.
 - Commissioner Cooper participated with federal regulators in a regulatory and legislative briefing at the IBAT Winter Summit held in South Lake Tahoe, Nevada. (2/12 – 2/14)
 - Deputy Commissioner Newberg and Director Purdom participated in a meeting of the Central Texas SAR (Suspicious Activity Report) Review Team. Attending were representatives from the U.S. Department of Justice, FinCEN, and IRS. (2/16)
 - FDIC Banker Outreaches were conducted in Dallas and Austin. Commissioner Cooper participated in a regulator's panel. Also attending were Deputy Commissioner Bacon, Director Purdom, Regional Directors and Review Examiners. (3/6 and 3/8)
 - Commissioner Cooper attended a Community Bankers' Roundtable meeting hosted by FDIC Acting Chairman Gruenberg. (3/7)
 - Commissioner Cooper gave a presentation to the University of Texas – Dallas Institute for Excellence in Corporate Governance. (3/9)
 - Commissioner Cooper attended the Independent Community Bankers Association (ICBA) National Convention held in Nashville, Tennessee. (3/11 – 3/13)
 - Commissioner Cooper attended the U.S. House of Representatives Hearing on "Challenges Facing Small Financial Institutions in Today's Economic Climate" held in San Antonio. (3/14)
 - Commissioner Cooper and Regional Director Kuntschik participated in the CSBS Board of Directors meeting and Legislative Fly-in held in Washington, D.C. (3/18 – 3/21)
 - Director Purdom participated in regulatory panels sponsored by the Greater Houston Area Bankers Association and the Texas Bankers Association held in Houston and San Antonio, respectively. (3/26 and 3/29)
- Strategic Planning: Representative staff members from all levels of the agency participated in the Department's strategic planning session held in Austin. (2/22 – 2/23)
- Federal Programs:
 - TARP – Eighty of our banks applied to participate in the Capital Purchase Program under the Troubled Asset Relief Program (TARP). However, after significant withdrawals, only 21 banks received funds totaling \$2.8 billion, with one bank receiving about 80% of this total. As of March 15, 2012, nine banks have not repaid any of their TARP funds. The total outstanding amount is approximately \$311 million.
 - Small Business Lending Fund (SBLF) – Twenty-three Texas state-chartered banks applied for funds under this program. Twelve banks received funds totaling \$255.7 million. The remaining banks either withdrew their applications or their applications were denied.



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To: Finance Commission Members

From: Daniel Frasier, Director of Corporate Activities

Date: March 30, 2012

Subject: Summary of the Corporate Division Activities

DBF

Corporate Activities		Applications and Notices Processed					
Entities	FY2010	FY2011	2Q11	3Q11	4Q11	1Q12	2Q12
*Banks and bank-related (holding companies, etc.)	259	212	48	66	46	49	48
Foreign Banks	5	6	1	1	3	3	1
Trust Companies	19	18	5	6	4	1	2
MSBs	19	14	2	3	3	6	5
PCSEAs	11	15	5	1	4	4	1
CVEs	5	4	4	0	0	0	4
Other (Use of Name)	59	62	18	10	18	10	19
Totals	377	331	83	87	78	73	80

Entities/Activities	Application and Notices Under Review (as of February 29, 2012)
*Banks and bank-related (holding companies, etc.)	14
Foreign Banks	1
Trust Companies	5
MSBs	9
PCSEAs	0
CVEs	0
Other (Use of Name)	0
Totals	29

*Includes all types of applications and notices for each entity.

Division Highlights

- The overall volume of applications processed for the most recent fiscal quarter finished on track with what we have seen in recent quarters. Money Services Businesses applications have continued to come in at an elevated pace as compared to prior years.
- We have seen a marked pickup in inquiries about conversions to a Texas state banking charter since The Frost National Bank announced their intent to convert in late January of this year.

Finance Commission Memorandum
Corporate Activities

- The following transactions were consummated during the second quarter of the 2012 fiscal year:
 - *Banks*
 - Bank of Texas, Austin merged with and into Prosperity Bank
 - Main Street Bank, Kingwood completed its voluntary liquidation that culminated in a merger with its parent holding company, MS Financial, Inc.
 - *Trust Companies*
 - N/A



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To: Finance Commission Members

From: Russell Reese, Director of Special Audits

Date: April 2, 2012

Subject: Summary of the Special Audits Division Activities

Special Audits					FY 2012							
Entity	FY2010		FY2011		1	2	3	4	5	6	7	8
Industry Profile (# / Assets (billions))												
MSB	130	\$71.5	128	\$80.7	130	\$81.1	131	81.0				
PFC	404	\$2.96	396	\$3.1	396	\$3.09	398	3.1				
PCC	244	\$238.3	245	\$239.9	243	\$239.0	243	257.2				
PCSEA	12	n/a	10	n/a	10	n/a	10	n/a				
CVE	4	n/a	4	n/a	4	n/a	4	n/a				
Examinations Performed												
MSB	94		106		25		14					
MSB Limited Scope	3		0		4		0					
MSB Accepted other State	5		3		0		0					
PFC	260		285		40		68					
PFC Limited Scope	11		3		4		2					
PCC	237		173		67		68					
PCC Limited Scope	9		3		2		4					
Recent Ratings (# / %) Assigned to All Regulated Entities												
1			317	42%	298	39%	278	37%				
2			363	48%	360	48%	364	48%				
3,4, & 5			78	10%	99	13%	113	15%				
Noncompliance with Examination Priorities (Past Due)												
MSB	6		5		3		9					
PFC	3		29		35		22					
PCC	5		69		42		17					
Enforcement Actions												
MSB	1		2		0		0					
PFC	6		7		1		2					
PCC	6		1		0		1					
PCSEA	1		0		0		0					

NOTES:

PCC \$ amounts reflected in the millions.

Limited scope examinations do not receive a rating.

Below is a breakdown on all past due exams:

- The nine past due MSB examinations are on average approximately one month past due.
- The 22 past due PFC examinations are on average 1.6 months past due.
- The 17 past due PCC examinations are on average 1.4 months past due.
- Our current examination schedule reflects that all past due examinations noted above will be completed by June 30, 2012.

Division Activities:

- On March 13th, the Department met with representatives of the Consumer Finance Protection Bureau (CFPB) in Austin to discuss our agency's current complaint handling processes. CFPB selected four states to visit to gain an understanding of the current complaint process for non-bank industries. CFPB will utilize their findings when drafting their complaint processes and procedures. CFPB also visited separately with representatives from SML and the OCC.
- On April 3-5th, DC Newberg and Senior Examiner Saucillo will attend FinCEN's Financial Crimes Conference hosted by the Texas Attorney's Office in Austin.
- On April 16th, Director Reese will give a presentation on perpetual care regulations (PCC) regulations to members at the Texas Cemeteries Association annual convention in San Antonio.
- During the week of May 7th, Director Reese and Senior Examiner Gonzalez will be instructors at MTRA's Intermediate Examiner School in San Diego, CA.
- Director Reese continues to participate with various other state representatives to provide feedback to CSBS in their efforts to expand the current Nationwide Mortgage Licensing System (NMLS) system to allow for the registration of non-depository license holders, which include MSBs.
- The Department finalized its review of the seized records of the Howell-Doran Funeral Home, Inc. (Howell-Doran), in San Saba, Texas, for misappropriating funds collected from the sale of numerous prepaid funeral contracts. The Department was able to ascertain that approximately \$200,000 in trust funds and an additional \$100,000 in insurance premiums were collected by the owner of Howell-Doran that were not trusted properly or forwarded to the insurance-funded permit holder as required. On March 20th, the Department met with representatives from the San Saba County District Attorney's office in Llano, Texas, to discuss taking criminal action against Kevin Keeney, the funeral home owner. A Departmental administrative hearing for this seizure has been postponed pending the completion of the criminal proceedings.

ACTUAL PERFORMANCE FOR OUTPUT/EFFICIENCY MEASURES

TEXAS DEPARTMENT OF BANKING

FISCAL YEAR 2012

Period Ending 2/28/2012

Actual Performance for Output/Efficiency Measures

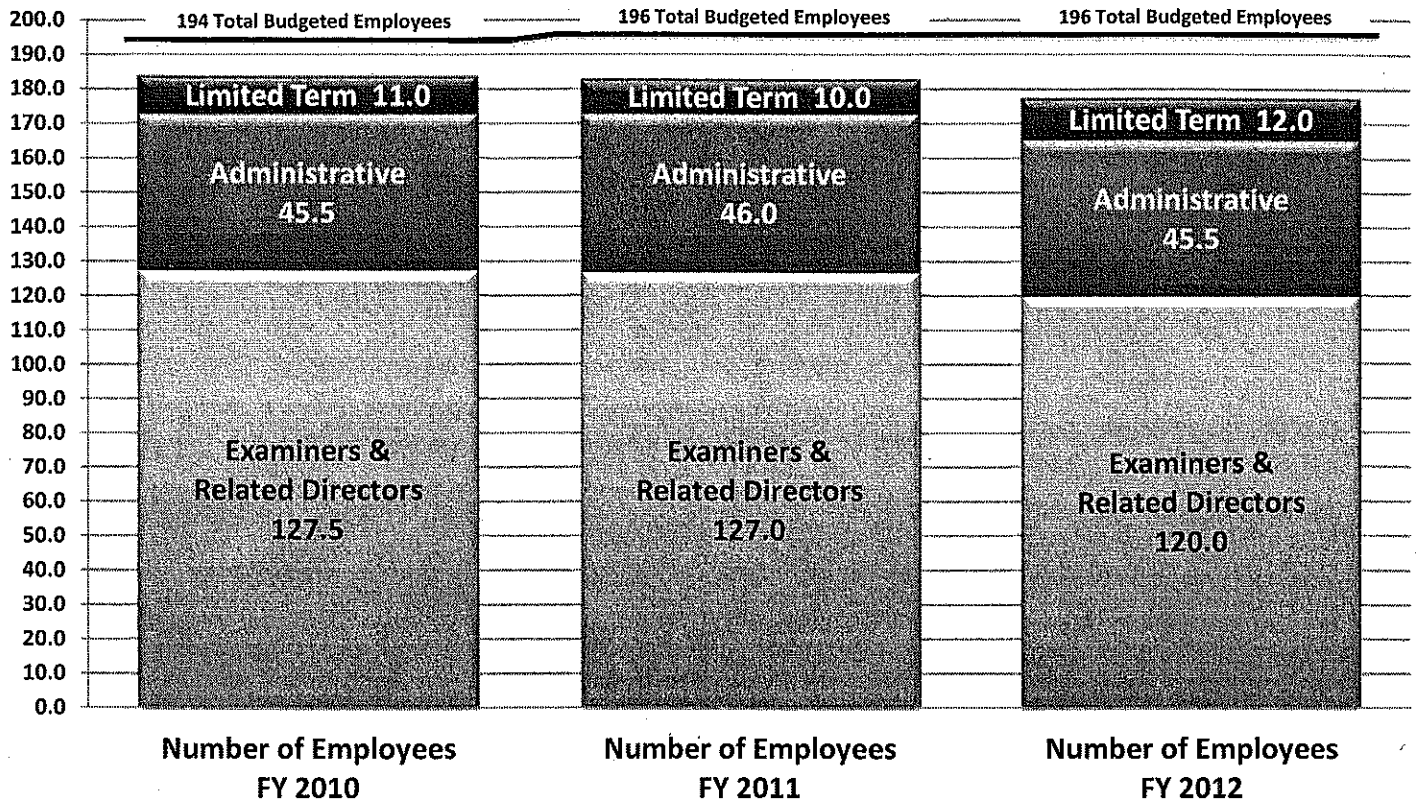
Type/Strategy/Measure	2012 Target	2012 Quarter	2012 YTD	Percent of Annual Target	
Output Measures-Key					
1-1-1	BANK EXAMINATION				
	1. # BANK EXAMINATIONS PERFORMED				
	Quarter 1	159	40	40	25.16%
**	Quarter 1	159	39	39	24.53%
	Change to the 1st quarter output measure was due to data entry error.				
	Quarter 2	159	40	79	49.69%
	2. # TRUST/IT EXAMINATIONS PERFORMED				
	Quarter 1	272	63	63	23.16%
	Quarter 2	272	69	132	48.53%
1-2-1	NON-BANK EXAMINATION				
	1. # SPECIAL AUDIT LICENSEES EXAMINED				
	Quarter 1	600	142	142	23.67%
	Quarter 2	600	156	298	49.67%
1-3-1	APPLICATION PROCESSING				
	1. # LICENSE APPLICATIONS COMPLETED				
	Quarter 1	319	73	73	22.88%
	Quarter 2	319	80	153	47.96%

* Varies by 5% or more from target.

** Updates/Corrections to measures after closing period.

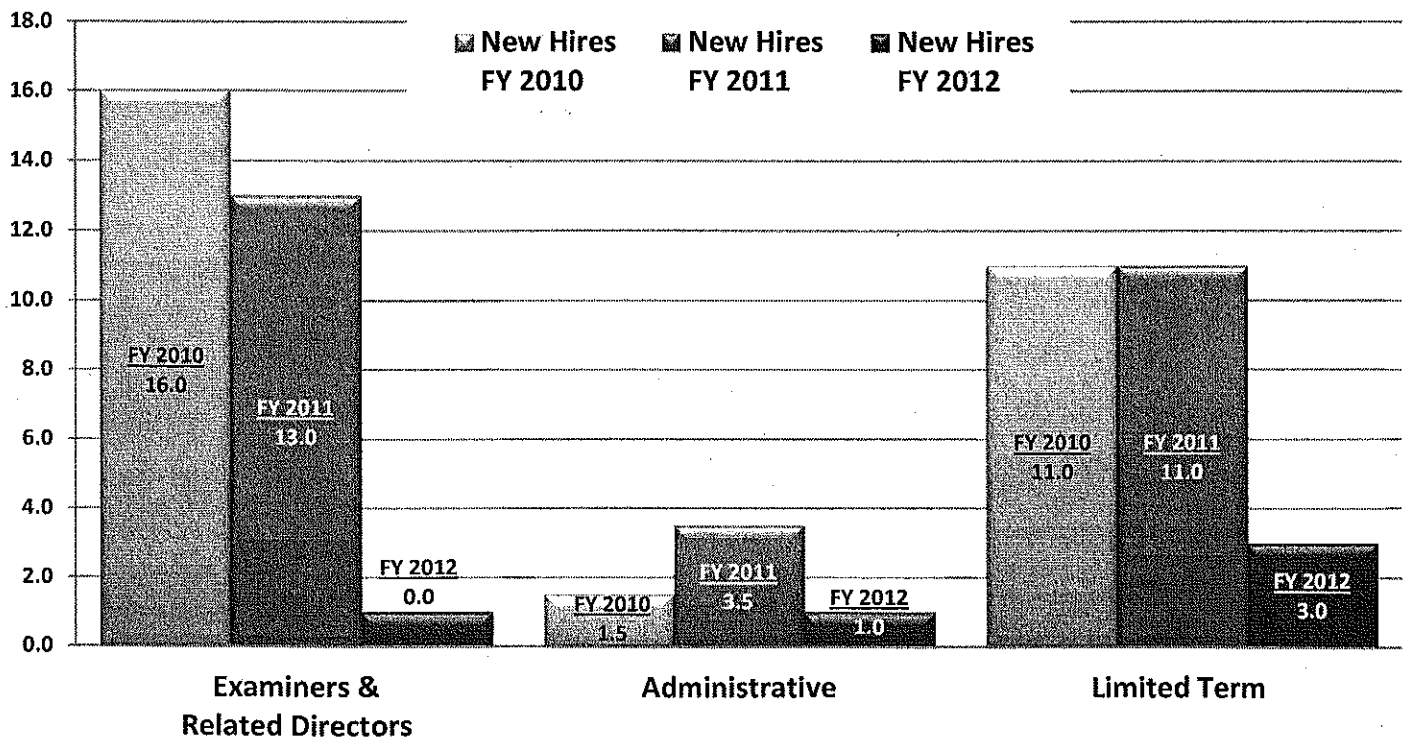
For the first six months of fiscal 2012, the Department's actual performance is within the 5% variance allowed by the Legislative Budget Board and the measures are considered met.

Texas Department of Banking Employee Data for Fiscal Years 2010, 2011 and 2012



As of 2/29/2012

Texas Department of Banking New Hire Data for Fiscal Years 2010, 2011 and 2012

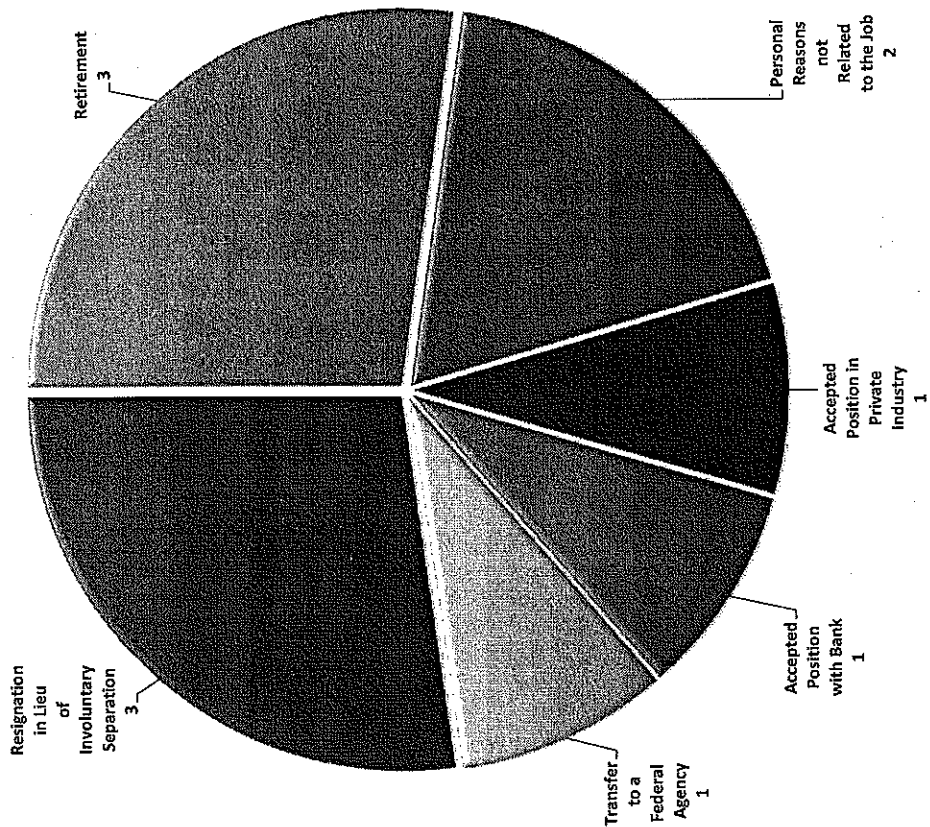


As of 2/29/2012

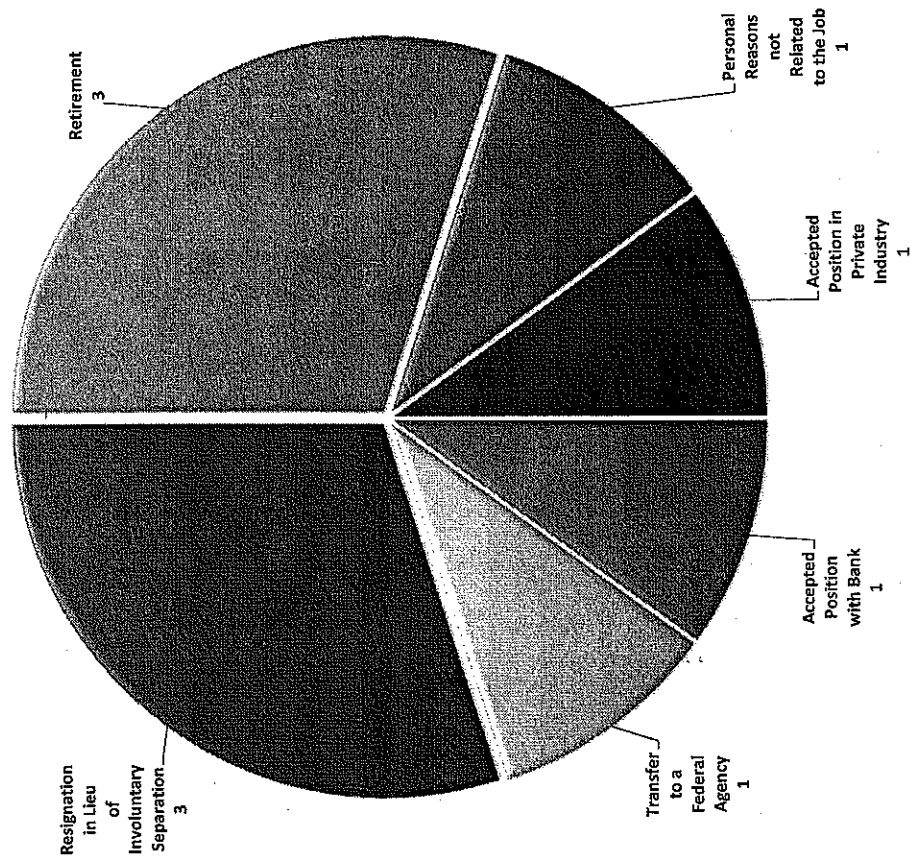
Texas Department of Banking

FY 2012 Employee Turnover

FY 2012 Employee Turnover Reasons
As of 2/29/2012
All Employees
11 Resignations



FY 2012 Employee Turnover Reasons
As of 2/29/2012
Financial Examiners Only
10 Resignations





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To: Finance Commission Members

From: Wendy Rodriguez, Director of Strategic Support *WR*

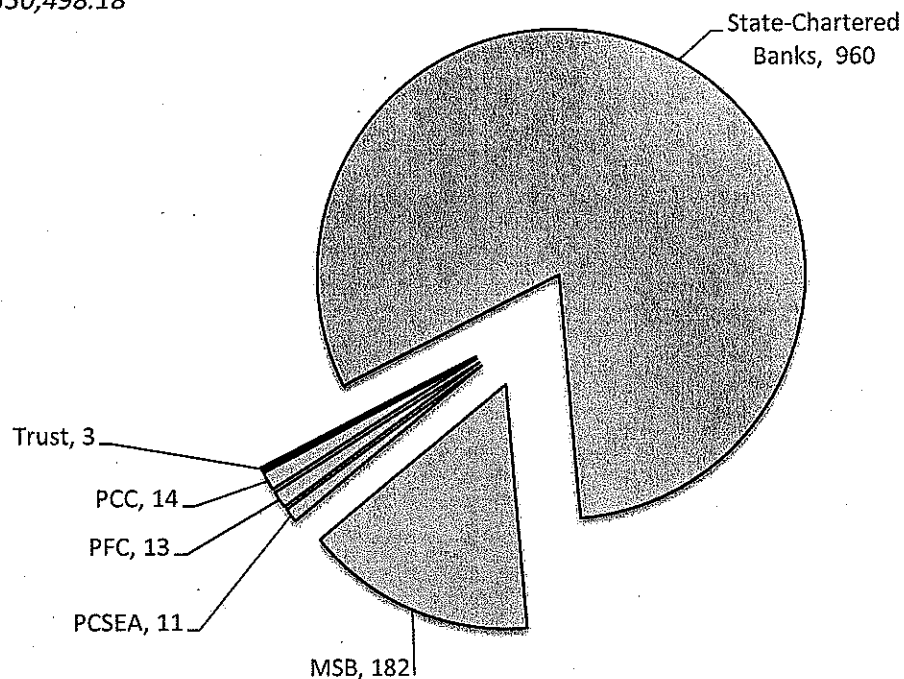
Date: April 4, 2012

Subject: Summary of the Strategic Support Division Activities

Complaints and Inquiries on Regulated Entities September 2011 - February 2012

Recoveries = \$30,498.18

Total = 1,183

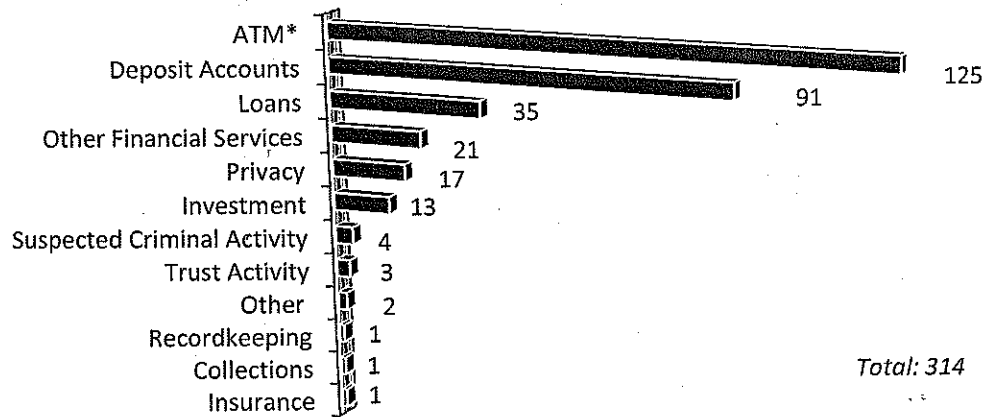


Average Number of Days to Close a Complaint

Type	Sept. – Feb.
State-Chartered Banks	15
Trust*	n/a
PCSEA	1
PFC/PCC	30
MSB	30

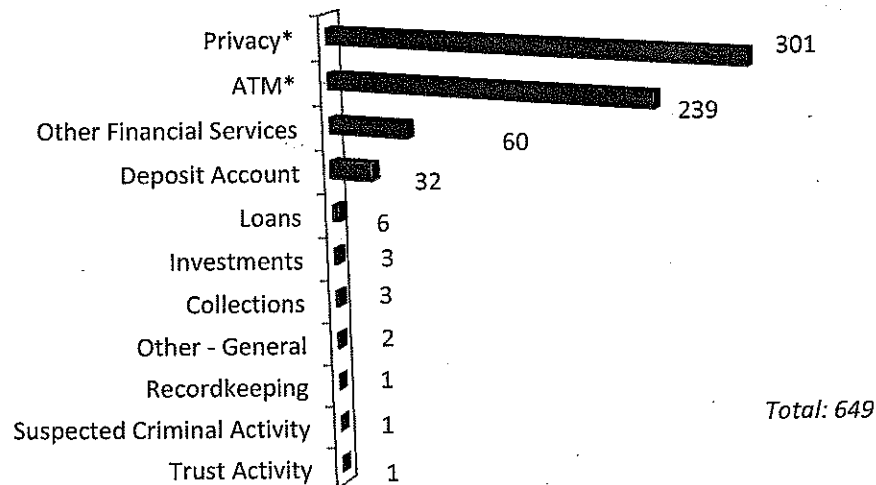
* Response was given on same day as complaint was filed.

**State-Chartered Banks and Trust Companies
Complaints by Type
September 2011 - February 2012**



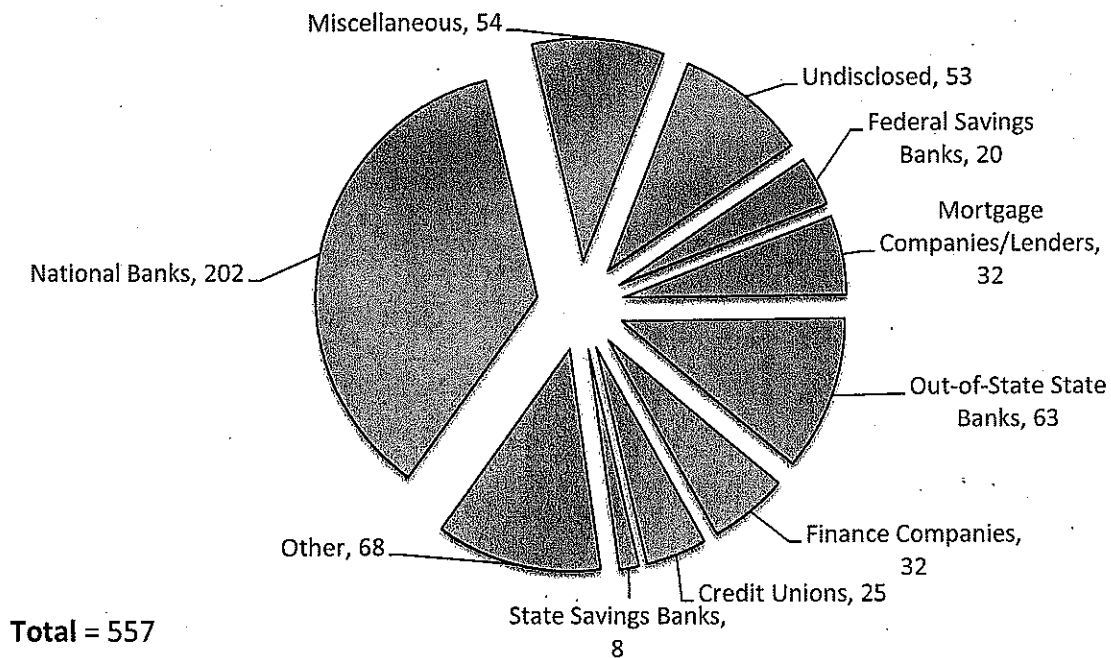
*High activity related to annual privacy notice containing the Department's contact information. Consumers complaints range from needing clarification of the notice to account balance issues and card related problems.

**State-Chartered Banks and Trust Companies
Inquiries by Type
September 2011 - February 2012**



*High activity related to annual privacy notice containing the Department's contact information. Consumers questions range from needing clarification of the notice to general account balance questions.

Complaints and Inquiries Against Nonregulated Entities September 2011 - February 2012



CANS Activity March 2008 – March 31, 2012		
Entity	Enrolled	Compromised Accounts Reported
Texas State-Chartered Banks	273	1,953
Texas State-Chartered Savings Banks	26	94
Federal Savings Banks	12	196
State Credit Unions	158	1,714
Federal Credit Unions	229	1,629
National Banks	183	1,017
Out-of-State State-Chartered Banks	14	3
Out-of-State National Banks	7	72
Total	902	6,678

Other Division Information:

- The Department's Strategic Planning Taskforce met February 22-23, 2012 in Austin. The next meeting will be in May 2012.
- The Examiner Staff Conference will be held April 9-12, 2012, in Austin.



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Memorandum

TO: Finance Commission Members

FROM: Kaylene Ray, General Counsel *AKR*

DATE: April 2, 2012

RE: Legal Division Update

Litigation

State of Texas v. Stephenville Memorial Gardens, Inc., Cause No. 30853, In the 266th District Court of Erath County, Texas. This case is a petition and application for revocation of charter and appointment of a receiver for Stephenville Memorial Gardens Cemetery. The receiver has advised the Special Audits Division that they do not have any prospects for a buyer at this time.

In re Timothy John Gaffney, Case No. 11-6-634-cag, United States Bankruptcy Court, Western District of Texas (Waco). The Department has a judgment that is close to \$1 million against Mr. Gaffney resulting from the illegal sale of prepaid funeral benefits and failure to apply payments to the contracts. Mr. Gaffney has filed for Chapter 7 bankruptcy and the Department has filed its claim in that proceeding. On April 2, 2012, the Department filed an objection to the discharge of Mr. Gaffney's debt to the Department. On March 23, 2012, Mr. Gaffney was sentenced in Travis County District Court, per a plea agreement, to 10 years probation. He paid \$100,000.00 in restitution on that date, which will be remitted to the insurance-funded permit holder that funded many of his contracts. The terms of his probation include a requirement that he pay an additional \$294,329.11 to the same permit holder.

Texas Department of Banking v. Greg Abbott, Attorney General of Texas; Cause No. D-1-GV-11-001906, In the 53rd District Court of Travis County, Texas. On December 7, 2011, the Department filed this lawsuit to appeal an open records ruling by the Attorney General (Opinion #OR2011-17444, dated November 29, 2011) requiring the disclosure of confidential information contained on executive calendars over the past ten years. An answer was filed on December 28, 2011. There has been no further activity in the case at this time.

Orders

During February and March 2012 the Commissioner issued five orders. The Legal Division assisted with the following final public order.

Order No. 2012-001, dated 3/8/12; Written Agreement in conjunction with the Federal Reserve Bank of Dallas; Central Bancorp, Inc., Garland, TX.

Order No. 2012-003, dated 2/16/2012; Agreed Order; J&B Funeral Home, Inc. dba Gatesville Funeral Home, Gatesville, TX.

Order No. 2012-005, dated 2/27/2012; Agreed Order; Lonnie D. Wright, Sr. dba Angel Hills Funeral Home, Arlington, TX.

Order No. 2012-006, dated 2/28/2012; Approving Family Limited Trust Association Charter of Legacy Trust Company, LTA, Dallas, TX.

Order No. 2012-007, dated 3/5/2012; Order to Cease and Desist Activity and Seize Prepaid Funeral Records; Nathan Shannon, Former Owner of Shannon-McBee Family Funeral Home, Matador and Paducah, TX.

2. Discussion of and Possible Vote to Take Action on the Adoption of Amendments to 7 TAC §12.7 Concerning Lease Financing, 7 TAC §12.9 Concerning Aggregation and Attribution, and 7 TAC §12.10 Concerning Nonconforming Loans.

PURPOSE: The purpose of the amendments is:

§12.7(b) -- to expand application of the rule to the purchase of leases from leasing companies in addition to loans to leasing companies. The amendment clarifies when leases purchased by a bank from leasing companies will be considered to be loans to the lessees.

§12.9(e) -- to reduce the current legal lending limit for a bank's loans to a corporate group from 75% to 60% of Tier 1 capital. This will reduce the potential risk of loss to state banks making loans or extensions of credit to affiliated borrowers.

§12.10 -- to add a new Subsection (a)(3) which permits a loan to be treated as non-conforming if it exceeds the legal lending limit because the bank has merged with another depository institution or purchased assets of a failed bank.

The Department received no comments on the proposed amended rules.

RECOMMENDED ACTION: The Department recommends that the Commission approve adoption of the amended rules as published in the *Texas Register*.

RECOMMENDED MOTION: I move that we adopt amendments to 7 TAC §§12.7, 12.9 and 12.10, as published in the *Texas Register*.

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ADOPTION OF AMENDMENTS TO 7 TAC §§12.7, 12.9 and 12.10

Page 1 of 6

Title 7. Banking and Securities
Part 2. Texas Department of Banking
Chapter 12. Loans and Investments
Subchapter A. Lending Limits
7 TAC §§12.7, 12.9, 12.10

The Finance Commission of Texas (the commission), on behalf of the Texas Department of Banking (the department), adopts amendments to §12.7, concerning lease financing; §12.9, concerning aggregation and attribution; and §12.10, concerning nonconforming loans, without changes to the proposed text as published in the March 2, 2012, issue of the *Texas Register* (37 TexReg 1446).

Chapter 12, Subchapter A (§§12.1 – 12.11) implements Finance Code, §34.201, by providing detailed standards for calculating and applying a bank's legal lending limit.

The amendment to §12.7(b) clarifies when leases purchased by a state bank from a leasing company will be considered to be loans to the lessee for legal lending limit purposes. The amendment explicitly applies the existing requirements of §12.7(b) to leases purchased by a state bank. The amendment to the rule notifies state banks considering the purchase of leases of circumstances that will cause purchased leases to be loans to the leasing company for legal lending limit purposes. Under §12.7(b), as amended, a lease purchased by a state bank from a leasing company must meet the rule's six requirements to be considered a loan to the lessee. In addition, the amendment to §12.7(b) substitutes "company" for "corporation" in §12.7(b)(1), (2) and (4) to correct internal inconsistencies in references to leasing

companies.

Section 12.9 governs when loans or extensions of credit to one borrower will be attributed to another person. The amendment to §12.9(e) reduces the aggregate legal lending limit for loans or extensions of credit by a bank to affiliated borrowers within a "corporate group" from 75% to 60% of Tier 1 capital. The limit applies only to loans subject to the general lending limit and only if one of the three tests set forth in §12.9 applies to such loans. The rule also defines a corporate group. The remainder of §12.9(e) remains unchanged.

The commission previously amended §12.9(e) and other legal lending limit rules in Chapter 12 in 2007, in part to implement certain statutory provisions enacted by the 80th Texas Legislature. That statutory change deleted the concept of "certified surplus" in state law and required the state legal lending limit to be calculated based on "unimpaired capital and surplus" instead of "capital and certified surplus." In revising the legal lending limit rules in Chapter 12, the commission defined "unimpaired capital and surplus" as equivalent to "Tier 1 capital" in §12.2(1), and substituted "Tier 1 capital" for "capital and certified surplus," in §12.9(e). Although the 2007 amendment to §12.9(e) did not alter the 75% limit, it effectively increased the lending limit by expanding the capital base against which the lending limit is measured.

The prolonged stress in the commercial real estate market has increased the department's concerns about high concentrations at certain state banks of real

ADOPTION OF AMENDMENTS TO 7 TAC §§12.7, 12.9 and 12.10
Page 2 of 6

estate loans to affiliated borrowers. The amendment to §12.9(e) lowers the potential risk of loss to state banks making loans or extensions of credit to affiliated borrowers by reducing the aggregate legal lending limit for loans to affiliated borrowers within a corporate group from 75% to 60% of Tier 1 capital.

Section 12.10 specifies circumstances under which certain loans or extensions of credit that currently exceed the legal lending limit may be cited as non-conforming rather than as a violation.

The amendment to §12.10 adds new subsection (a)(3) to permit a loan to be treated as non-conforming rather than a violation if the loan exceeds the lending limit as a result of the bank's merger with another depository institution or purchase of all or substantially all of the assets of a failed depository institution from the Federal Deposit Insurance Corporation as receiver of such institution, on or shortly after the date of its closing.

Previous §12.10(a)(3), was renumbered as §12.10(a)(4), and amended to clarify that if the change in lending limit or capital definitions occurred after the date the loan or extension of credit was originated the loan will be considered non-conforming.

The amendment renumbers the remaining subsections and revises the internal cross-references.

The Department received no comments regarding the proposed amendments.

The amendments are adopted pursuant to Finance Code, §31.003, which authorizes the commission to adopt rules necessary or reasonable to implement and clarify applicable law; and under Finance Code, §34.201(b), which authorizes the commission to adopt rules regarding legal lending limits, including rules to define or further define terms used in the statute, establish limits, requirements, or exemptions other than specified by the statute for particular classes or categories of loans or extensions of credit, and establish collective lending limits.

§12.7. Lease Financing.

(a) Loans to industrial development authorities. Pursuant to the Finance Code, §34.201(b)(2), a loan or extension of credit to an industrial development authority or similar public entity created to construct and lease a plant facility, including a health care facility, to an industrial occupant is considered a loan to the lessee, provided that:

(1) the bank documents the basis for its reliance on the industrial occupant as the primary source of repayment before the loan is extended to the authority;

(2) the authority's liability on the loan is limited solely to whatever interest it has in the particular facility;

(3) the authority's interest is assigned to the bank as security for the loan or the industrial occupant issues a promissory note to the bank that provides a higher order of security than the assignment of a lease; and

ADOPTION OF AMENDMENTS TO 7 TAC §§12.7, 12.9 and 12.10

Page 3 of 6

(4) the industrial occupant's lease rentals are assigned and paid directly to the bank.

(b) Loans to or leases purchased from leasing companies. Pursuant to the Finance Code, §34.201(b)(2), a loan or extension of credit to a leasing company for the purpose of purchasing equipment for lease, or a lease purchased from a leasing company, is considered a loan to the lessee, provided that:

(1) the bank documents the basis for its reliance on the lessee as the primary source of repayment before the loan is extended to, or lease is purchased from, the leasing company;

(2) the loan is made, or lease is purchased, without recourse to the leasing company;

(3) the bank receives a security interest in the equipment and, in the event of default, may proceed directly against the equipment and the lessee for any deficiency resulting from the sale of the equipment;

(4) the leasing company assigns all of its rights under the lease to the bank;

(5) the lessee's lease payments are assigned and paid to the bank directly by the lessee; and

(6) the lease terms are subject to the same limitations that would apply to a state bank acting as a lessor under the Finance Code, §34.204.

§12.9. Aggregation and Attribution.

(a) General rule. A loan or extension of credit to one borrower is attributed to another person, and each person will be considered a borrower, if:

(1) proceeds of the loan or extension of credit are to be used for the direct benefit of the other person, to the extent of the proceeds so used, as provided by subsection (b) of this section;

(2) a common enterprise is deemed to exist between the persons as provided by subsection (c) of this section; or

(3) the expected source of repayment for each loan or extension of credit is the same for each person as provided by subsection (d) of this section; or

(4) notwithstanding another provision of this section, the banking commissioner determines that a loan should be attributed to another person pursuant to the Finance Code, §34.201(c).

(b) Direct benefit. The proceeds of a loan or extension of credit to a borrower is considered used for the direct benefit of another person and attributed to the other person if the proceeds, or assets purchased with the proceeds, are transferred in any manner to or for the benefit of the other person, other than in a bona fide arm's length transaction where the proceeds are used to acquire property, goods, or services.

(c) Common enterprise.

(1) A common enterprise is considered to exist and loans to separate borrowers will be aggregated in the case of:

(A) loans or extensions of credit made to affiliated borrowers if substantial financial interdependence exists between or among the borrowers; or

(B) loans made to separate persons for the purpose of acquiring more than 50% of the voting securities or voting interests of a business enterprise, in which case the acquisition loans are aggregated and attributed to the business enterprise.

(2) For purposes of paragraph (1)(A) of this subsection, borrowers are affiliated if one borrower directly or indirectly controls, is controlled by, or is under common control with another borrower. Substantial financial interdependence exists if 50% or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower and is presumed to exist, subject to rebuttal, if 25% or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower. Gross receipts and expenditures include gross revenues and expenses, intercompany loans, dividends, capital contributions, and similar receipts or payments.

(d) Source of repayment. The expected source of repayment for each loan or extension of credit is considered the same if

the primary source of repayment is the same for each borrower. An employer will not be considered a primary source of repayment under this subsection solely because of wages and salaries paid to an employee, unless the standards of subsection (c)(1) of this section are met.

(e) Loans to a corporate group. Pursuant to the Finance Code, §34.201(c), loans or extensions of credit by a bank to a corporate group may not exceed 60% of the bank's Tier 1 capital. This limitation applies only to loans subject to the general lending limit. For purposes of this subsection, a corporate group is comprised of a person and all of its subsidiaries, and a corporation or other entity is a subsidiary of a person if the person owns or beneficially owns directly or indirectly more than 50% of the voting securities or voting interests of the corporation or other entity. Subject to the special limit of this subsection, loans or extensions of credit to a person and its subsidiary, or to different subsidiaries of a person, are not aggregated or attributed to other members of the corporate group unless either the direct benefit, common enterprise, or source of repayment test is met.

(f) Loans to partnerships or partners.

(1) A loan or extension of credit to a partnership, joint venture, or association is considered to be a loan or extension of credit to each member of the partnership, joint venture, or association other than those partners or members that, by the terms of the partnership or membership agreement, are not held generally liable for the debts or actions of the partnership, joint venture, or association,

provided those provisions are valid against third parties under applicable law, and that have not otherwise agreed to guarantee or be personally liable on the loan or extension of credit.

(2) A loan or extension of credit to a member of a partnership, joint venture, or association is generally not attributed to the partnership, joint venture, or association, or to other members of the partnership, joint venture, or association, except as otherwise required by subsections (b) - (d) of this section, provided that a loan or extension of credit made to a member of a partnership, joint venture or association for the purpose of purchasing an interest in the partnership, joint venture or association, is attributed to the partnership, joint venture or association.

(g) Guarantors and accommodation parties. The derivative obligation of a drawer, endorser, or guarantor of a loan or extension of credit, including a contingent obligation to purchase collateral that secures a loan, is not aggregated with direct loans or extensions of credit to such drawer, endorser, or guarantor if the lending bank is relying primarily on the creditworthiness of the primary obligor and none of the tests set forth in this section are satisfied. The reliance of the lending bank on the primary obligor must be evidenced by the certification of an officer of the bank that the bank is, on stated facts, relying primarily on the responsibility and financial condition of the primary obligor for payment of the loan or extension of credit and not on the guarantee, or commitment in whatever form, of the guarantor, drawer, or endorser. In the event that the loan or extension of credit to the

primary obligor, considered by the bank to be of sufficient credit quality at its inception, experiences subsequent deterioration to the point that the primary obligor is no longer performing in accordance with the terms of the initial loan agreement, such event will not result in a lending limit violation on behalf of the guarantor by virtue of the primary obligor's nonperformance. However, the total amount of the deteriorated loans guaranteed by such accommodating person must be combined with all other obligations of such guarantor in determining whether the guarantor may obtain additional loans or extensions of credit from the bank.

§12.10. Nonconforming Loans.

(a) A loan or extension of credit, within a bank's legal lending limit when made, will not be considered a violation of the applicable lending limit but will be cited as nonconforming if the loan no longer complies with the bank's legal lending limit because:

(1) the bank's Tier 1 capital has declined;

(2) borrowers have merged or otherwise become affiliated in such a way as to invoke aggregation under §12.9 of this title (relating to Aggregation and Attribution);

(3) the bank has merged with another depository institution or the bank has purchased all or substantially all of the assets of a failed depository institution from the Federal Deposit Insurance Corporation as receiver of such institution on or shortly after the date of its closing;

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(4) the lending limit or capital definitions or standards have changed after the date the loan or extension of credit was originated; or

(5) collateral securing the loan or extension of credit to satisfy the requirements of a special lending limit or lending limit exception has declined in value.

(b) A bank must exercise reasonable efforts to bring a loan or extension of credit that is nonconforming as a result of circumstances described in subsection (a)(1)–(4) of this section into conformity with the legal lending limit, consistent with safe and sound banking practices. As a last resort, a bank may renew or restructure an existing, nonconforming loan or extension of credit as a new, nonconforming loan or extension of credit without violating the Finance Code or this subchapter, unless:

(1) additional funds are advanced by the bank to the borrower, except as permitted by §12.4(b) of this title (relating to Loan Commitments);

(2) the original borrower is replaced by a new borrower; or

(3) the banking commissioner determines that the renewal or restructuring of the loan or extension of credit is designed to evade the bank's lending limit.

(c) A bank must bring a loan or extension of credit that is nonconforming as a result of the circumstance described in subsection (a)(5) of this section into conformity with the

legal lending limit on or before the 31st day after the nonconformity is discovered unless judicial proceedings, regulatory action, or other extraordinary circumstances beyond the bank's control prevent the bank from taking action.

This agency hereby certifies that the adoption has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority.

Filed with the Office of the Secretary of State on April 20, 2012.

3. Discussion of and Possible Vote to Take Action on the Proposal and Publication for Comment of Amendments to 7 TAC §25.25 Concerning Prepaid Funeral Contracts.

PURPOSE: The amendments to §25.25 would set the minimum annual interest rate for conversion annuities between one percent (1%) and three percent (3%) based on prevailing market rates at the time of application rather than the two percent (2%) minimum annual rate used currently. This change will add flexibility in setting guaranteed interest rates used in conversion annuities.

RECOMMENDED ACTION: The Department recommends that the Commission approve publication of the proposed amended rule in the *Texas Register*.

RECOMMENDED MOTION: I move that we publish proposed amendments to 7 TAC §25.25, in the *Texas Register*.

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***Title 7. Banking and Securities
Part 2. Texas Department of Banking
Chapter 25. Prepaid Funeral Contracts
Subchapter B. Regulation of Licenses
7 TAC §25.25***

The Finance Commission of Texas (the commission), on behalf of the Texas Department of Banking (the department), proposes to amend §25.25, concerning conversion from trust-funded to insurance-funded benefits. The amendment is proposed to increase flexibility in setting guaranteed interest rates used in conversion annuities.

Existing prepaid contracts for trust-funded prepaid funeral benefits may be converted to insurance-funded prepaid funeral benefits under Finance Code, §154.204, if the department finds that the proposed insurance-funded arrangement safeguards the rights and interests of the individuals who purchased the prepaid contracts to substantially the same degree as the trust-funded arrangement proposed to be replaced. Pursuant to existing §25.25(c)(9)(A), the funding insurance policy must be a fixed annuity that provides guaranteed growth based on a minimum annual interest rate of two percent. This rate creates difficulties in the current low interest rate environment.

The proposed amendment to existing §25.25(c)(9)(A) will add flexibility to the interest rate determination to better balance the need for a fair return with the potential for long periods of low interest rates. The proposal will allow the minimum guaranteed fixed interest rate to be set between one percent and three percent, depending upon the yield of five-year treasury bonds at the time the application is approved. The

calculation method is patterned on the manner in which minimum nonforfeiture amounts for certain annuities are calculated under Insurance Code §1107.055.

In addition, for comparison purposes the proposal expands the historical yield table or graph required by §25.25(c)(11) to include annuities sold in this state in the last five years to fund new prepaid funeral contracts.

The proposal also makes conforming changes to §25.25(c)(16) and (17) and corrects cross-reference errors in §25.25(c)(4) and (19).

Stephanie Newberg, Deputy Commissioner, Texas Department of Banking, has determined that for the first five-year period the proposed rule is in effect, there will be no fiscal implications for state government or for local government as a result of enforcing or administering the rule.

Ms. Newberg also has determined that, for each year of the first five years the rule as proposed is in effect, the public benefit anticipated as a result of enforcing the rule is better conformity with the prevailing interest rate environment at the time of a conversion, thereby ensuring a fair return for the consumer at a rate that is affordable to the insurer.

For each year of the first five years that the rule will be in effect, there will be no economic costs to persons required to comply with the rule as proposed. There will be no adverse economic effect on small businesses or micro-businesses, and no difference in the cost of compliance for

small businesses as compared to large businesses.

To be considered, comments on the proposed amended section must be submitted no later than 5:00 p.m. on June 4, 2012. Comments should be addressed to General Counsel, Texas Department of Banking, Legal Division, 2601 North Lamar Boulevard, Suite 300, Austin, Texas 78705-4294. Comments may also be submitted by email to legal@dob.texas.gov.

The amendment is proposed under Finance Code, §154.204, which provides for department approval of a conversion from trust-funded prepaid funeral benefits to insurance-funded prepaid funeral benefits to safeguard the rights and interests of the individual who purchases a prepaid funeral benefits contract, and under Finance Code, §154.051, which authorizes the commission to adopt rules relating to the enforcement and administration of Chapter 154.

Finance Code, §154.204, is affected by the proposed amendment.

§25.25. Conversion from Trust-Funded to Insurance-Funded Benefits.

(a)-(b) (No change.)

(c) Contents of application. An application for conversion must respond to each paragraph of this subsection by number. Overlapping or duplicate responses may be cross-referenced for brevity.

(1)-(3) (No change.)

(4) Agreement of post-conversion permit holder and applicant. The applicant

must submit a written agreement between the post-conversion permit holder and the applicant that, at a minimum, requires the applicant to relinquish the individual prepaid contract ledgers formerly maintained by the applicant under §25.11 of this title (relating to Recordkeeping [~~Record—Keeping~~] Requirements for Trust-Funded Contracts) and obligates the post-conversion permit holder to maintain such ledgers to reflect the paid-in principal and the unpaid principal balance under each converted prepaid contract.

(5)-(8) (No change.)

(9) Form of annuity. The applicant must submit a copy of the form(s) of annuity proposed to be issued as part of the conversion. The submitted form(s) must be accompanied by a copy of the TDI notice of action approval letter. The applicant and not TDI is responsible for ensuring that the form of annuity complies with this section. Among other matters, the annuity must:

(A) provide guaranteed growth of the death benefit based on a fixed annual interest rate, [of no less than 2.0%] compounded annually on gross premiums paid beginning in the first year of the policy, that is at least equal to a rate determined as the lesser of:

(i) 3.0%; and

(ii) the average of the five-year Constant Maturity Treasury Rate reported by the Federal Reserve Board of Governors for the 90 calendar day period ending not more than 30 days prior to the date of the commissioner's order of approval, rounded to the nearest 1/20th of

PROPOSED AMENDMENTS TO 7 TAC §25.25

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one percent, less 125 basis points, but not less than 1.0%;

(B)-(D) (No change.)

(10) (No change.)

(11) Past performance. For purposes of this paragraph, the annual growth under an annuity equals the growth rate credited by the insurance company to the death benefit for the year. The applicant must submit separate [an] historical yield tables or graphs [table or graph] reflecting the annual rate of growth in the death benefit, expressed as a percentage for each year of the most recent five-year period, under;

(A) previously issued annuities similar to the form of annuity proposed to be issued by the insurance company in the proposed conversion, [expressed as a percentage for each year of the most recent five-year period,] to the extent such annuities were in existence in those periods; and

(B) annuities sold by the insurance company in this state during the most recent five-year period for the purpose of funding new prepaid funeral contracts. [For purposes of this paragraph, the annual growth under the annuity equals the growth rate credited by the insurance company to the death benefit for the year.]

(12)-(15) (No change.)

(16) Pre-conversion summary. The applicant must submit a pre-conversion summary pertaining to each prepaid contract to be converted, determined as of a date no earlier than 30 days prior to the date the

application is filed, with totals for all prepaid contracts to be converted, if applicable, addressing each of the following categories:

(A)-(G) (No change.)

(H) amount eligible to be withdrawn from the trust fund by the applicant upon death of the contract beneficiary, assuming death were to occur on the calculation date; [and]

(I) amount retained by the applicant under Finance Code, §154.252; and

(J) the guaranteed minimum interest rate to be applied to the death benefit calculated as if the date of the application were the date of the commissioner's order of approval.

(17) Pro forma post-conversion summary. The applicant must submit a pro forma post-conversion summary pertaining to each prepaid contract as if converted, determined as of the same date as the pre-conversion summary, with totals for all prepaid contracts, if applicable, addressing each of the following categories:

(A)-(F) (No change.)

(G) cash surrender value of each annuity, assuming the annuity were to be surrendered on the calculation date; [and]

(H) death benefit under each annuity, assuming death were to occur on the calculation date; and

(I) the guaranteed minimum interest rate to be applied to the death benefit, including the actual calculation as determined under subsection (c)(9)(A) of this section.

(18) (No change.)

(19) Application fee. In connection with an application submitted under this section, the applicant must submit the conversion application fee required by §25.23 of this title (relating to Application and Renewal Fees).

(20) (No change.)

(d)-(e) (No change.)